STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**05/03/05**	Bill No:	**SB 942**
Tax:	**Cigarette Pollution and Litter Prevention Fee**	Author:	**Chesbro, et al.**
Related Bills:	**AB 1612 (Pavley)**		

BILL SUMMARY

This bill would require each manufacturer of cigarettes to pay a cigarette pollution and litter prevention fee for each package of cigarettes sold by that manufacturer in the state, as specified.

Summary of Amendments

Since the previous analysis, the bill was amended to require the Board to collect the fee, revise the definition of cigarette, clarify how the revenues may be expended, prohibit a distributor from affixing a tax stamp onto a package of cigarettes unless provided proof of payment from the manufacturer, and make other clarifying changes.

ANALYSIS

Current Law

Pursuant to Revenue and Taxation Code Section 30101 (Cigarette and Tobacco Products Tax Law), an excise tax of 6 mills (or 12 cents per package of 20) is imposed on each cigarette distributed. In addition, Sections 30123 and 30131.2 impose a surtax of 12 1/2 mills (25 cents per package of 20) and 25 mills (50 cents per package of 20), respectively, on each cigarette distributed. The current total tax on cigarettes is 43 1/2 mills per cigarette (87 cents per package of 20).

Of the 87 cent excise tax imposed on a package of 20 cigarettes, 2 cents is deposited into the Breast Cancer Fund, 10 cents into the General Fund, 25 cents into the Cigarette and Tobacco Products Surtax Fund, and 50 cents into the California Children and Families First Trust Fund (CCFF Trust Fund).

Proposed Law

This bill would add Division 12.8 (commencing with Section 19000) to the Public Resources Code as the Cigarette Pollution and Litter Prevention Act of 2005 (Act).

CIGARETTE POLLUTION AND LITTER PREVENTION FEE

This bill would require each manufacturer to pay, on July 1, 2006, a cigarette pollution and litter prevention fee for each package of cigarettes sold by that manufacturer in the state during the previous six months calendar year, as reported to the Board. Each six months thereafter, a manufacturer would be required to pay the fee to the Board based upon the number of packages of cigarettes, as reported to the Board.

The Board would collect the fees pursuant to the Fee Collection Procedures Law (Part 30 (commencing with Section 55001) of Division 2 of the Revenue and Taxation Code).

This bill also provides that a manufacturer is required to annually pay the fee of not more than five mills per cigarette, or ten cents ($0.10) per package of 20 cigarettes. The fee paid by the manufacturer would be in an amount that is not greater than the costs of the environmental, public health, and societal burdens that are mitigated pursuant to the Act.

A distributor would be prohibited from affixing a cigarette stamp onto a cigarette package unless the manufacturer provides to the distributor proof of payment of the fee.

FINANCIAL PROVISIONS

The Board would deposit all fees collected under this chapter into the Cigarette Pollution and Litter Prevention Fund (Fund), which this bill would create in the State Treasury. The revenues in the Fund would be available for expenditure by the Department of Conservation (Department) and the State Department of Health Services (DHS), upon appropriation by the Legislature, for all of the following purposes and programs in the following amounts:

- Fifty percent to be allocated to state and local governments for prevention and cleanup of cigarette related pollution and litter.
- Twenty-eight percent to develop and implement public education and outreach programs by public agencies and nonprofit organizations aimed at educating the public on the public health and environmental problems resulting from the improper discard of cigarette remnants.
- Five percent to the DHS to assist individuals to access and utilize smoking cessation services.
- Five percent to develop and implement public education, media advertising, and outreach programs aimed at preventing individuals from starting to smoke.
- Five percent to develop and implement effective community interventions aimed at reducing the harm caused by cigarettes.
- Two percent to reimburse the Board for the costs of administering and collecting of the fee imposed pursuant to the Act.
- Two and one-half percent to the DHS for administering the Act.
- Two and one-half percent to the Department for administering the Act.

DEFINITIONS

This bill would define the following terms:

- "Cigarette" – has the same meaning as in Section 30003 of the Revenue and Taxation Code which defines “cigarette” to mean any roll for smoking, made wholly or in part of tobacco, irrespective of size or shape and irrespective of whether the tobacco is flavored, adulterated or mixed with any other ingredient, where such roll has a wrapper or cover made of paper or any other material, except where such wrapper is wholly or in the greater part made of tobacco and such roll weighs over three pounds per thousand.
- "Cigarette package" - an individual packet, box or other container in which retail sales of cigarettes are normally made or intended to be made. "Package" does not include a container that is a carton, case, bale, or other box and that contains smaller packaging units of cigarettes.
- "Manufacturer" - a person who manufactures a cigarette.

The bill would become effective January 1, 2006.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the American Lung Association and Californians Against Waste and is intended to hold manufacturers of cigarettes financially liable for all of the adverse public health and environmental effects of their products, including tobacco addiction and cigarette related litter.
2. **The May 3, 2005 amendments** require the Board to collect the fee, revise the definition of cigarette, clarify how the revenues may be expended, prohibit a distributor from affixing a tax stamp onto a package of cigarettes unless provided proof of payment from the manufacturer, and make other clarifying changes. The previous version of the bill required the Department to collect the fee, but would have allowed that agency to contract with the Board or another party for collection of the fees.
3. **Would this fee capture all cigarettes sold in California?** This bill would require each manufacturer to pay a cigarette pollution and litter prevention fee for each package of cigarettes <u>sold by that manufacturer</u> in the state, as specified. In its current form, this fee would not capture cigarettes sold in the state by persons other than the manufacturer. For example, it is not uncommon for a licensed distributor located in another state to purchase cigarettes from a manufacturer in that state, affix a California cigarette tax stamp, and ship those cigarettes into California for sale to a California consumer. Under such a scenario, the sale by the manufacturer takes place outside California and would not be subject to the proposed fee.

   Furthermore, manufacturers could easily avoid this fee by not selling cigarettes in the state. Instead, manufacturers could sell cigarettes to distributors outside the state for subsequent shipment into the state by that distributor.

If it is the author's intent to capture the fee on all cigarettes sold in this state, it is suggested that the fee imposed upon manufacturers be based on packages of cigarettes distributed in California. Cigarettes distributed in California would include those packages of cigarettes upon which a California cigarette tax stamp has been affixed. The bill should also include provisions to require distributors to report the number of packages of cigarettes stamped by manufacturer for purposes of imposing the appropriate fee upon manufacturers. This suggestion, however, would impose an additional reporting requirement upon licensed distributors.

And lastly, it should also be noted that collecting the proposed fee from foreign manufacturers would be difficult, if not impossible, if that manufacturer does not have nexus within this state. Therefore, it is suggested that the fee also be imposed upon importers of cigarettes sold in this state and that the term importer be defined. The term "importer" should have the same meaning as that term is defined in Section 30019 of the Revenue and Taxation Code, which provides that an importer is any purchaser for resale in the United States of cigarettes manufactured outside of the United States.

4. **This bill does not specify a fee amount.** This bill provides that the fee would not be more than five mills per cigarette and would be in an amount that is not greater than the costs of the environmental, public health, and societal burdens that are mitigated pursuant to the Act. This provision is vague as to how the fee amount would be established. For example, what agency would be responsible for computing the amount of the fee? How would the fee be computed? How often would the fee rate change? Would the Board be notified timely of fee amounts in order to bill manufacturers?

   In order to properly administer this new fee program, it is necessary that guidelines of how and by whom the fee is to be calculated be clearly provided in law. Without clear guidance, administration of the proposed fee would add a significant level of complexity and disputes.

5. **This bill does not provide lead-time for reports, billings and payments.** This bill would impose a fee on July 1, 2006 for each package of cigarettes sold in the state during the previous six months. Each six months thereafter, each manufacturer would pay the fee based on the number of packages of cigarettes sold in the state during the previous six months. As such, the fee on packages of cigarettes sold from January 1, 2006 through June 30, 2006 would be due to the Board on July 1, 2006. This and all subsequent due dates would only be <u>one day</u> following the last day of the period for which the packages of cigarettes were sold. This does not allow sufficient time for the Board to generate billings or for the manufacturer to pay the fee. It is suggested that the fee be due on or before 30 days from the date of the Board's determination (billing).

6. **Cost cap could be problematic.** This bill would create a new fee program to be administered by the Board. The provisions in this bill provide that reimbursement to the Board to cover the cost of administering and collecting the fee would be limited to an amount not to exceed 2 percent of revenues deposited in the Fund. Based on a revenue estimate of $120 million annually if the fee is imposed at an amount of ten

cents ($0.10) per package of cigarettes, the Board would be reimbursed for costs up to $2.4 million annually. Since the implementation and administration costs have not yet been estimated by the Board, it is not known at this time if the cost cap would provide the Board with sufficient funding to administer the fee.

7. **Certificate of proof of payment.** This bill would prohibit a distributor from affixing a stamp to a package of cigarettes unless the manufacturer provides to the distributor proof of payment of the fee imposed pursuant to this measure. However, it is not clear who would enforce this provision. The bill is specific with respect to the Board's responsibilities, which is to collect the cigarette pollution and litter prevention fee.

   Furthermore, how would this provision be enforced? For example, what are the consequences if a distributor affixes a stamp to a package of cigarettes without manufacturer proof of payment? Would those packages of cigarettes be subject to seizure by law enforcement? Would the distributor be subject to fines or penalties?

8. **Other technical concerns.** Board staff is available to work with the author's office to draft appropriate amendments to address the following concerns:

   - It is suggested that the bill be amended to authorize the payment of refunds on overpayments of the fee from the Fund.
   - This bill provides in Section 19003(a) that a manufacturer shall annually pay the proposed fee; however, subdivision (b) of that same section imposes a biannual fee.
   - Section 19004(a), which is contained in Chapter 4, provides that the Board shall deposit all fees collected under this "chapter" into the Fund. However, there are no fees collected under Chapter 4. The proposed fees are collected pursuant to Chapter 3. As such, the reference to "this chapter" in Section 19004(a) should be revised to read "chapter 3" or "division."
   - Section 19003(b) provides that each six months thereafter, a manufacturer shall pay a fee to the Board, based upon the number of packages of cigarette reported to the Board. What packages of cigarettes reported to the Board? Packages of cigarettes sold or shipped? And for what period? The previous six-months? The bill should be amended to clarify these ambiguities.

9. **This bill could increase state and local sales and use tax revenues.** In order to be reimbursed for the fee, cigarette manufacturers may increase the price of cigarettes, which would be reflected in the retail sales price of cigarettes sold to the ultimate consumer.

   Sales and use tax is due based on the gross receipts or sales price of tangible personal property in this state. Since the proposed fee would not be specifically excluded from gross receipts or sales price, it would be included in the amount on which sales or use tax is computed.

10. **Would the proposed cigarette pollution and litter prevention fee increase evasion?** Tax evasion is one of the major areas that can reduce state revenues from cigarettes and tobacco products. Board staff recently estimated that cigarette

tax evasion in California was running at a rate of approximately $292 million annually. That estimate was only for evasion of cigarette taxes, and did not include associated evasion of other taxes, such as sales and use, tobacco products or income taxes.

A key premise in the Board's research is that both cigarette consumption and cigarette tax evasion are highly correlated to product prices and excise tax rates. For example, two major events that occurred since November 1998 dramatically increased California excise taxes as well as cigarette prices excluding taxes: Proposition 10 and the Tobacco Master Settlement Agreement made between states and tobacco manufacturers (tobacco settlement). Together, these two developments, when coupled with typical wholesaler and retailer distribution margins, have increased average prices of cigarettes to California consumers by about 50 percent in relation to early November 1998 prices. It was estimated that the impacts of Proposition 10 and the tobacco settlement more than doubled cigarette tax evasion in California.

This bill would impose an unspecified fee on each person who manufactures a cigarette, as specified. This fee could result in an increase in the selling price of cigarettes, which based on the Board's findings when developing the impacts of Proposition 10 and the tobacco settlement, could cause a correlated increase in tax evasion.

11. **Legal challenges of any new fee program might be made on the grounds that the fee is a tax.** In July 1997, the California Supreme Court held in *Sinclair Paint Company v. State Board of Equalization* (1997) 15 Cal.4th 866 that the Childhood Lead Poisoning Prevention Act of 1991 imposed bona fide regulatory fees and not taxes requiring a two-thirds vote of the Legislature under Proposition 13. In summary, the Court found that while the Act did not directly regulate by conferring a specific benefit on, or granting a privilege to, those who pay the fee, it nevertheless imposed regulatory fees under the police power by requiring manufacturers and others whose products have exposed children to lead contamination to bear a fair share of the cost of mitigating those products' adverse health effects.

    The *Sinclair Paint* decision ratified the use of fees approved by a majority of the Legislature to address health or other social problems created by the use or production of a particular product. In order to pass judicial scrutiny, the Court suggests that: 1) a fee must not exceed the cost of providing services related to the remediation of the problem created by a particular product; and 2) a reasonable connection must exist between the social problems remedied by a fee and the payer of the fee.

    Although this measure has been keyed by the Legislative Counsel as a majority vote bill, opponents of this measure might question whether the fees imposed are in legal effect "taxes" required to be enacted by a two-thirds vote of the Legislature.

12. **Related legislation.** Assembly Bill 1612 (Pavley) would require a manufacturer of cigarettes to pay a cigarette pollution and litter prevention fee for each package of cigarettes distributed for sale to consumers in the state, as specified. The fee would be collected by the Board pursuant to the Fee Collection Procedures Law.

COST ESTIMATE

The Board would incur non-absorbable costs to adequately develop and administer a new fee program. These costs would include registering fee payers, developing computer programs, mailing and processing determinations and payments, carrying out compliance and audit efforts to ensure proper reporting, developing regulations, training staff, answering inquiries from the public and investigative efforts. A cost estimate of this workload is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

Based on statistics compiled from the Board's Excise Taxes Division cigarette reports, the total number of cigarette packs distributed in 2003-04 was 1.2 billion packs. Based on the proposed fee of $0.10 per package of cigarettes, the revenue is estimated to be $120 million ($0.10 per pack × 1.2 billion packs = $120 million).

Sales and Use Tax Impacts

We assume that all cigarette tax increases are passed on to consumers.

Revenue Summary

Based on the proposed maximum fee of ten cents ($0.10) per package of cigarettes, an estimated $120 million in annual fee revenues could be generated for the Cigarette Pollution and Litter Prevention Fund, which this bill would create in the State Treasury.

In addition, an additional $9.5 million in State and Local sales and use tax annually would be generated as follows:

	FY 2005-06 (half year)	FY 2006-07
Litter Fee	$60.0 million	$120.0 million
State (5.25%)	3.2 million	$ 6.3 million
Local (2.0%)	1.2 million	2.4 million
District (.67%)	0.4 million	0.8 million
Total	$64.8 million	$129.5 million

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